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October 17, 2006

AGENDA ITEM 7

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: Long-Term Care Program 2005 and Earlier Policies – Proposed Mitigation Plan – First Reading

II. PROGRAM: Health Program

III. RECOMMENDATION: Information Only

IV. ANALYSIS:

Staff and the Long-Term Care Advisory Committee (Advisory Committee) continue discussions regarding the deficit position of the Long-Term Care Program (Program). A draft copy of the proposed mitigation strategy prepared by the Program's consulting actuary (United Health Actuarial Services, Inc.) was presented to the Advisory Committee meeting on October 3, 2006 and is attached (Attachment 1). The draft copy of the June 30, 2006 Valuation report is included for your review (Attachment 2). Based upon the above referenced reports, staff's proposal for a mitigation strategy remains unchanged from the material presented to the Board at the August meeting.

The staff's proposal was based on the following assumptions:

- CalPERS does not have the ability to subsidize this Program with other business lines or financial reserves as does other Long-Term Care insurance carriers.

- The Program began at a point in time where the Long-Term Care insurance marketplace was relatively new and volatile.

- The Long-Term Care marketplace has matured with many insurers leaving the market; the ones that remain, or are entering the market, are savvier and more financially stable.

- In recent years, new policy sales for this Program have been low but generally better than in the individual Long-Term Care marketplace. New policies have balanced departures with total policies-in-force remaining basically flat. Based upon this, the Program cannot look to expand to cover the projected deficit.

- The CalPERS Board has approved two concepts to change the focus of the Program; 1) build reserves and no longer have a “break-even” Program, 2) do not continue to cross subsidize across products.
- In order for CalPERS to compete on a level field with commercial carriers, it would require a segmentation of the current risk pool through two-party discounts (spousal), prime, average, and sub-average rates and other discounts and incentives linked to more restrictive underwriting.
- An expansion of market penetration (new sales), would require a substantial commitment of additional assets including a real sales force (an agent network) as opposed to the marketing currently undertaken by the Program.

Staff Recommendation

Based on the history of the Program and the facts uncovered through in-depth research and discussion, staff recommends that the Program focus on ensuring there are adequate reserves to meet the demands of current in-force policies. Staff and the consulting actuary propose a premium rate increase (included in Attachment 1) for all 2005 and prior policies which would be self sufficient within each individual product cell to support the development of a comprehensive mitigation plan. The proposed rate increase is based upon the 2006 rates, with the exception of “lifetime” policies which will be increased to a more appropriate pricing level. This increase is to be adequate enough to build reserves with no cross subsidization for either plan design or age group. This proposal builds reserves without placing an unfair cost burden or disincentives for younger or newer policy holders. With this rate increase, members will be allowed a one-time opportunity to choose between two options as an alternative to the rate increase:

> 1) The member can step back to a lower Daily Benefit Allowance (DBA), (with a waiver of the underwriting requirements and utilization of their age at issuance into the Program), or
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> 2) The member can step back from the “lifetime” policy to a six-year (or shorter) term policy (with a waiver of the underwriting requirements and utilization of their age at issuance into the Program).

Claims experience for this program and broader industry information indicate that for most members a lifetime policy represents an unnecessary cost and over-insurance. Overall, the implementation of this rate increase will bring in-force premium rates in-line with 2006 rate levels.

Staff further recommends that this premium increase become effective on July 1, 2007 or the next available billing date for those members that are not billed on a monthly basis.

The Program’s consulting actuary has provided rate increases that would be based on the following assumptions:

- Based on 2006 base case valuation results and targeting a 3% margin, the projected funding deficit as of June 30, 2006 is approximately 39.6%
- Spreading of rate increases across a one-time increase or a corresponding two-step implementation
- Continuation of the age adjustment (socialization) rate increase used for the 2003 rate increase, but with a more smoothing across the age groupings. The age adjustment should be modified to narrow the range of adjustment and provide a higher minimum rate increase than occurred in 2003
- Accounted for the impact of future new business assuming that 2005 products would continue for the next ten years
- Accounted for a 2.5% additional future morbidity improvement identified by the Long-Term Care Group staff.

Included in the mitigation proposal is a comparison of the proposed new rates (for 2006 as approved by the Board, estimated post increase 2004 and prior rates, and the 2005 rates after adjustment based on the proposed rate increase) and rates available in the commercial market for similar coverage. On an individual basis, the Program's rates generally remain competitive, but any pricing advantage tends to erode when the discounts available from other commercial carriers are applied.

Staff has been provided with a draft copy of the Mercer parallel valuation requested by the Board. The complete report from Mercer will be provided under separate cover by Audit Services. The draft Mercer report does provide an opinion on the proposed mitigation plan and concludes that the plan "… is reasonable and appropriate given the uncertainty inherent in this type of projection." In addition, Mercer concludes that the proposed mitigation plan would produce program surpluses somewhere between 7% and 10% of the present value of future premiums. Based on these comments, staff feels that the proposed mitigation strategy provides an appropriate response for Board consideration to address the continuing issues of solvency for the Program.

The Advisory Committee met on October 3rd, and discussed the mitigation proposal and the draft results from the parallel valuation prepared by Mercer. The Advisory Committee will provide the Board with their recommendations that will include, among other items:

- a two year phase in any rate increase
- the offer to step back from a life time policy to a six year policy without a rate increase
- permit program participants to buy down or step back in policy benefits based on original age of entry
- inclusion of a 5 year rate "guarantee"
- minimal "socialization" of any rate increase to limit the impact on plan participants at ages 75 and older

As this is a first reading, staff is not requesting any Board action at this time. However, staff will continue to review and coordinate proposals with the Advisory Committee, the Program's consulting actuary, and Mercer in order to bring a final proposal for action to the November meeting.

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Richard J. Krolak, Chief
Office of Health Plan Administration

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Attachments